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No. 85-1079

In the Supreme Court of the United States

OCTOBER TERM, 1985

AMERICAN POUCH FOOD CO., INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether a Department of Defense procurement contract providing that "title to all * * * [property] * * * acquired or produced by the [c]ontractor and allocable or properly chargeable to this [c]ontract * * * shall forthwith vest in the Government" passes title to the government in such property, thereby removing the property from competing claims in the event of the contractor's bankruptcy.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A50) is reported at 769 F.2d 1190. The opinion of the district court (Pet. App. A51-A89) is reported at 30 B.R. 1015. The opinions of the bankruptcy court (Pet. App. A92-A107) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1985 (Pet. App. A108-A109) and a petition for rehearing was denied on September 24, 1985 (Pet. App. A110-A111). The petition for a writ of certiorari was filed on December 20, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner entered into a contract with the Defense Logistics Agency to produce approximately $22 million worth of combat rations (Pet. 3). The contract included both a "progress payments" provision and a "title-vesting" clause. Under the former, petitioner was entitled to receive payments from the government in advance of delivery.[1] Petitioner received approximately $13 million in progress payments pursuant to this provision (Pet. App. A4). Under the literal terms of the title-vesting clause, title to all parts, materials, inventories, and work in progress acquired or produced by petitioner under the contract immediately vested in the government.[2]

The government terminated petitioner's contract for default after petitioner did not meet production schedules established by the contract (Pet. App. A4). Three days later, petitioner filed a petition for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 101 *et seq.* (Pet. App.

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[1]A standard provision regarding progress payments to small businesses is published at 32 C.F.R. 163.79.

[2]The title-vesting clause in the contract provided, in pertinent part (Pet. App. A3):

> (d) *Title.* Immediately, upon the date of this contract, title to all parts; materials; inventories; work in progress; * * * theretofore acquired or produced by the Contractor and allocable or properly chargeable to this Contract under sound and generally accepted accounting principles * * * shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor and allocable or properly chargeable to this contract as aforesaid shall forthwith vest in the Government upon said acquisition, production or allocation. Notwithstanding that title to property is in the Government through the operation of this clause, the handling and disposition of such property shall be determined by applicable provisions of this contract such as: the Default clause and paragraph (h) of this clause; Termination for Convenience of the Government clause; and the Special Tooling clause * * *.

A4). The government subsequently filed a complaint in the bankruptcy court to gain possession of the property produced or acquired by petitioner that was allocable to the contract (*id.* at A4-A5). Petitioner filed an answer alleging that the government's legal interest in the property amounted to no more than a lien or unperfected security interest subordinate to the rights of the debtor and other creditors (*id.* at A5).[3]

The bankruptcy court held that the government had title to the property covered by the title-vesting clause and, accordingly, was entitled to immediate possession of such property (Pet. App. A92-A96). Petitioner appealed to the district court, which, after initially ruling that remaining factual disputes prevented entry of judgment in favor of the government (*id.* at A90-A91), ultimately affirmed the bankruptcy court's ruling (*id.* at A51-A85).

The court of appeals affirmed (Pet. App. A1-A33). The court concluded (*id.* at A24) that the government became entitled to possession of all property covered by the title-vesting clause upon termination of petitioner's contract. The court commented (*id.* at A21-A22) that there was "no reason [to] depart[] from the consistent holdings before and after 1958 that the title vesting clause is to be taken literally."[4]

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[3]Petitioner included in its answer, filed January 16, 1981, a counterclaim seeking damages for wrongful termination of the contract (Pet. App. A5, A55). The district court abstained from hearing petitioner's counterclaim on the ground that the claim would be better heard by the Armed Services Board of Contract Appeals (*id.* at A85-A89). The court of appeals affirmed the district court decision (*id.* at A25-A33) and petitioner does not contest this aspect of the lower courts' rulings in its petition for a writ of certiorari.

[4]Judge Swygert, dissenting (Pet. App. A33-A50), contended that the priority of the government's interest in the property in a bankruptcy proceeding should at least in part turn on application of Illinois law. The dissent admitted (*id.* at A49 n.9) that it was "quite likely" that the

ARGUMENT

The decision of the court of appeals is correct, is consistent with decisions of this Court, and does not create a conflict with decisions of other courts of appeals that warrants this Court's review.

1. Petitioner claims (Pet. 11-15) that the decision of the court of appeals is inconsistent with this Court's decision in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979). No such inconsistency exists. *Kimbell Foods* concerned the relative priority of contractual liens arising from federal loan programs and in no manner addressed the legal effect of a title-vesting clause in Defense Department contracts. Here, the legal import of the title-vesting clause is plain. "[I]t is * * * well settled that if the contract is such as to clearly express the intention of the parties * * *, and this purpose is expressed in the words of the contract, it is binding and effectual in law to pass the title." *United States* v. *Ansonia Brass & Copper Co.*, 218 U.S. 452, 467 (1910). See also *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 524 (1958) (Whittaker, J., dissenting).

In *Kimbell Foods*, moreover, this Court looked to the Uniform Commercial Code as a possible basis for resolving the competing rights of the parties only because there was no "federal statute setting priorities" (440 U.S. at 718). In this case, as the court of appeals explained (Pet. App. A9, A10-A16), the appropriateness of a literal reading of the "clear and precise language of the contract * * * grant[ing] the Government title" is confirmed by the relevant statutory backdrop.

In 1958, Congress amended 10 U.S.C. 2307 to authorize progress payments, primarily "to improve opportunities for small business concerns to obtain a fair proportion of

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government would ultimately prevail even under the dissent's "proposed disposition of the case."

Government purchases and contracts." S. Rep. 2201, 85th Cong., 2d Sess. 1 (1958). Progress payments were not expressly sanctioned by statute prior to 1958, but, as the court of appeals found (Pet. App. A16), "the practice of contracting for progress payments in return for title had been followed for many years." Congress did not specifically require continuation of this practice, opting instead for a general requirement of "adequate security" for progress payments (10 U.S.C. 2307(c)).[5] Still, it is appropriate to assume that Congress approved of title-vesting clauses, such as the one in issue here, in light of congressional knowledge of the settled administrative practice[6] and the absence of indicia of congressional intent to the contrary. See *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979).

Finally, the decision below is consistent with decisions of this Court that have assumed that the title-vesting clause passes title to the government (*United States* v. *Allegheny County*, 322 U.S. 174, 178, 183 (1944); see also *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 491 (1958) (partial

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[5]The literal terms of 10 U.S.C. 2307(c) refer only to "advance payments" and not to "progress payments" but, as both the majority and dissent below found (Pet. App. A15, A38), "we can think of no reason why Congress could have intended less protection for the Government when making progress payments than when making advance payments." Indeed, the Senate Report on the 1958 legislation discusses Section 305(c) (subsequently codified at 10 U.S.C. 2307(c)) in terms of "the exercise of the proposed advance payment (and progress payment) authority." S. Rep. 2201, 85th Cong., 2d Sess. 8 (1958).

[6]"[A] special task force of experienced [agency] procurement personnel * * * participated in the development of the proposed legislation" and "[t]he bill was screened and approved by all of the affected [federal] agencies * * *." S. Rep. 2201, 85th Cong., 2d Sess. 2 (1958). The Comptroller General, moreover, advised Congress of his view "that the authority to make 'progress' payments should not be provided, unless provision is also made to preserve to the Government the *right to take title* to or receive a lien paramount" (*id.* at 12) (emphasis added).

payments)), and with decisions of lower courts that have in comparable circumstances " 'almost unanimously sustained the [clause] as effecting a full and complete passage of title or ownership, and as not creating only a lien or security interest.' " *In re Double H Products Corp.*, 462 F.2d 52, 55 (3d Cir. 1972), quoting *Boeing Co.* v. *United States*, 338 F.2d 342, 345 (Ct.Cl. 1964), cert. denied, 380 U.S. 972 (1965); *United States* v. *Digital Products Corp.*, 624 F.2d 690 (5th Cir. 1980); *Shepard Engineering Co.* v. *United States*, 287 F.2d 737, reh'g denied, 289 F.2d 681 (8th Cir. 1961); *In re Verco Industries*, 27 Bankr. 615 (9th Cir. 1982). Courts have stressed the special need for immediate government title in Defense Department contracts; the government cannot afford to have title to property necessary for national defense depend on the outcome of protracted commercial litigation (*United States* v. *Digital Products Corp.*, 624 F.2d at 692; see also *In Re Double H Products*, 462 F.2d at 55 n.4).

2. Petitioner erroneously contends (Pet. 16-17) that the decision below presents a conflict with *In re Murdock Machine & Engineering Co.*, 620 F.2d 767 (10th Cir. 1980), and *United States* v. *Lennox Metal Mfg. Co.*, 225 F.2d 302 (2d Cir. 1955), that merits this Court's review. Any inconsistency between either of these cases and the decision below falls far short of that necessary to warrant this Court's attention.

In *Murdock*, the Tenth Circuit held that the government was not entitled to possession of property purchased by the contractor on credit and still in transit from the seller when the contractor filed for bankruptcy (620 F.2d at 768-769). The decision in *Murdock* did not disturb the view that a title-vesting clause passes title to the property to the government. Indeed, the court assumed the clause had that effect (*id.* at 769). The Tenth Circuit's ruling turned, therefore, not on the legal effect of the title-vesting clause (see *id.*

at 775) — the central question in this case — but on unique factual circumstances, involving the special rights of a seller of goods in transit, not present in the instant case.[7]

Similarly, the Second Circuit's decision 31 years ago in *Lennox Metal* does not create a conflict between the circuits requiring this Court's resolution. To be sure, in *Lennox Metal*, the court appeared to suggest (225 F.2d at 317) that the government's interest in the property acquired or produced by the contractor was no more than an equitable lien that could be defeated by the inequitable nature of the government's termination of the contract. In *Lennox Metal*, however, the government's right to possession depended on a clause entitled "Termination for Convenience of the Government," which provided that in the event of its exercise the contractor shall "transfer title and deliver to the government [property] produced as a part of, or acquired in connection with the [contractor's] performance" (*id.* at 316). The Second Circuit's decision that the government was not entitled to legal possession turned, in effect, on the inequitable nature of the government's exercise of the termination clause (*id.* at 317-318).

In the present case, the title-vesting clause took effect "[i]mmediately, upon the date of [the] contract" (Pet. App. A3). The clause was not triggered by some subsequent act of termination by the government. Also, unlike *Lennox Metal* (see 225 F.2d at 318), there is no suggestion in this case that the government's termination of petitioner's contract was tainted by extreme inequity. Finally, it is not even clear that *Lennox Metal* remains good law in the Second Circuit (see,

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[7]Several courts have suggested that *Murdock* is limited to cases involving reclaiming sellers under Article 2 of the Uniform Commercial Code. *Marine Midland Bank* v. *United States*, 687 F.2d 395, 403 (Ct. Cl. 1982), cert. denied, 460 U.S. 1037 (1983); *In re Verco Industries*, 27 Bankr. at 619.

e.g., United States v. *Ameco Electronic Corp.*, 224 F.Supp 783, 786 (E.D.N.Y. 1963)), particularly because the decision predates congressional passage of the 1958 amendment expressly authorizing progress payments. Any possible inconsistency between the circuits based on *Lennox Metal*, therefore, is simply too stale to merit this Court's review.[8]

3. Finally, contrary to petitioner's contention (Pet. 19-23), this case does not present an issue of sufficient importance to warrant this Court's attention. Petitioner asserts (*id.* at 20) that the case involves a fundamental collision between two conflicting policies: (1) "special treatment * * * to the Government [in] the world of private commerce"; and (2) "abhor[rence] * * * of 'secret' liens against property of insolvent estates." No such "collision" is suggested by this case. Indeed, neither *United States* v. *Speers*, 382 U.S. 266 (1965), nor the 1978 amendment to the Bankruptcy Code, both cited by petitioner (Pet. 21), has any bearing on this case. The former involved the relative priority of an unrecorded tax lien, not the power of the government to insist upon immediate vesting of title in its procurement policies; the latter concerned the relative priority of unsecured non-tax debts owed the government, not property owned by the government in the debtor's possession. See H.R. Rep. 95-595, 95th Cong., 1st Sess. 285 (1977).

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[8]Petitioner also suggests (Pet. 19 n.8) that the Court of Claims' decision in *Marine Midland Bank* v. *United States*, 687 F.2d 395 (Ct. Cl. 1982), cert. denied, 460 U.S. 1037 (1983), is inconsistent with the decision of the court below. As petitioner readily concedes (Pet. 19 n.8), however, any theoretical inconsistency between the two decisions does not aid petitioner. Whether the interest of the government is viewed as a vested property right (the opinion of the Seventh Circuit) or as a paramount lien (the view of the Court of Claims in *Marine Midland Bank*) is no matter. Under either view, the government would prevail in this case. Consequently, petitioner's claim does not provide a suitable vehicle to present the issue to this Court. See para. 3, *infra*.

A more appropriate characterization of the issue raised in this case is whether the interest of the government in property acquired or produced by a government contractor receiving progress payments amounts to "title" vested in the government or a "paramount lien" held by the government.[9] In the instant case the label chosen — title or paramount lien — is irrelevant to the result. In either event, petitioner would not be entitled to relief. Under these circumstances, petitioner has raised no important legal issue that warrants this Court's review.

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[9]Even assuming that the literal meaning of the title-vesting clause did not dispose of petitioner's claim, the interest of the government in petitioner's property should, in the alternative, be considered a paramount lien as a matter of federal law. See *Marine Midland Bank* v. *United States*, 687 F.2d 395 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983). Even the dissent below, which advocated this alternative theoretical framework, agreed (Pet. App. A33, A38) that a federal rule of law would apply (see generally *United States* v. *Kimbell Foods, Inc.*, 440 U.S. at 726) and that 10 U.S.C. 2307 would require that the lien receive priority. The dissent's only dispute concerned whether the state law of perfection should also apply to the government, thereby creating a "hybrid law" with both federal and state elements (see Pet. App. A40). We agree with the majority below (*id.* at A20-A21) that the state law of perfection should not apply. "[A]pplication of state law would frustrate specific objectives of * * * federal programs" (*Kimbell Foods*, 440 U.S. at 728), including the use of progress payments to attract small and minority-owned businesses and the need for immediate government access to property that could be essential to national defense. In all events, however, we note that the dissent agreed (Pet. App. A49 n.9) that even should state law apply, it was "quite likely" that the government would still prevail.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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